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IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1950

No. 995 125

AVERY BRUNDAGE, and ELIZABETH D. BRUNDAGE,
Petitioners,

vs.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

Avery Brundage and Elizabeth D. Brundage (hereinafter referred to as "petitioners"), respectfully pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Seventh Circuit, entered in the above case on February 5, 1960. Timely motions for rehearing and rehearing in banc were denied March 30, 1960.

OPINIONS BELOW

The opinion of the Court of Appeals for the Seventh Circuit is reported in 275 F. 2d 424, and is printed in its entirety in the Appendix hereto. No opinion was rendered

by the District Court for the Northern District of Illinois, Eastern Division. The Findings of Fact and Conclusions of Law of the District Court are reported in 4 AFTR 2d 5007, and in 59-2 U.S.T.C. Par. 9527, and are printed in their entirety in the Appendix for Plaintiffs-Appellants filed by petitioners in the Court of Appeals, nine copies of which have been filed with this Petition pursuant to Rule 21(4) of the Rules of this Court. Such Findings of Fact and Conclusions of Law are not officially reported.

JURISDICTIONAL GROUNDS

The judgment order of the Court of Appeals was entered on February 5, 1960, and is printed in the Appendix hereto. A timely petition for rehearing was filed by petitioners and an order denying said petition was entered on March 30, 1960. On that same date, the court sitting in banc denied (with one judge dissenting) petitioners' petition for rehearing in banc. The two orders denying said petitions are printed in the Appendix hereto. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

This is a suit for refund of federal income taxes turning on whether petitioners are to be taxed as having received dividend income upon the sale of certain stock. The precise statement of the questions involved necessitates a brief summary of the facts.

Petitioners owned certain shares of prior preference stock of Portland Electric Power Company (hereinafter referred to as "Portland"). This corporation was involved in a bankruptcy reorganization proceeding in the United States District Court for the District of Oregon. A formal Plan of Reorganization was confirmed by the District Court on

October 11, 1947. Pursuant to the Plan, petitioners had the right on and after February 2, 1948, and until June 4, 1951, to exchange their Portland stock for stock of Portland General Electric Company (hereinafter referred to as "PGE"), the wholly-owned operating subsidiary of Portland. Such an exchange, if made, would have been a taxable exchange in liquidation of Portland. Petitioners made no such exchange but sold their Portland stock on the open market for cash during 1948.

Prior to the confirmation of the Plan, the directors of PGE declared a special dividend of $2.00 per share to be paid to the holders of PGE stock when and if such stock should be issued pursuant to the Plan. In the order confirming the Plan, the Oregon District Court took this dividend into account as part of a "fair and equitable" distribution of the Portland assets. After the confirmation of the Plan, but prior to its effective date of February 2, 1948, the directors of PGE declared two additional dividends of 45¢ each per share to be paid on the PGE stock on a "when and if" basis. In addition, after the effective date of the Plan, and prior to the sale by petitioners of their Portland stock, the directors of PGE declared two dividends of 45¢ each per share to be paid when and if holders of Portland stock exchanged such stock for PGE stock and then only pursuant to an assignment of such dividends by the Independent Trustees of Portland to the holders of the Portland stock at the time of such exchange.

Respondent contended, and the District Court and Court of Appeals held, that a portion of the sales price received by petitioners for their Portland stock should be taxed as dividend income, rather than as proceeds of sale of the Portland stock.

The questions presented are:

1. Where petitioners sold their Portland stock on the open market without ever having exchanged it for PGE stock, can they be taxed as having constructively received dividends on PGE stock, or as having assigned PGE dividends when they sold their Portland stock?

2. Even if petitioners had actually received the so-called "dividends" in question, would not such amounts have been entitled to capital gain treatment as amounts distributed in liquidation of Portland?

STATUTES AND REGULATIONS INVOLVED

The statutory provisions involved in this controversy are sections 22(a), 115(a) and 117(c) of the Internal Revenue Code of 1939, 26 U.S.C. §§ 22(a), 115(a) and 115(c). Sections 29.22(a)-1, 29.22-2, 29.42-3 and 29.115-5 of Treasury Regulations 111, interpreting the Internal Revenue Code of 1939, and section 1.61-9 of Treasury Regulations interpreting the Internal Revenue Code of 1954 are also pertinent. The statutes and regulations are quoted in the Appendix hereto.

STATEMENT OF THE CASE

This is a suit to recover federal income tax in the amount of $39,076.12 paid by petitioners as a deficiency for the calendar year 1948, plus interest in the amount of $7,731.07 paid by petitioners on said deficiency, a total of $46,807.19, plus interest on said total as allowed by law. The case was submitted upon a stipulation of facts to the District Court of the United States for the Northern District of Illinois, Eastern Division. After submission by petitioners and respondent of briefs and proposed Findings of Fact, Conclusions of Law and Judgment Orders, the District Court

entered an order adopting respondent's draft Findings of Fact and Conclusions of Law as those of the court and dismissing petitioners' complaint with prejudice at petitioners' costs. No opinion, written or oral, was rendered.

On appeal, a three-judge division of the United States Court of Appeals for the Seventh Circuit affirmed, Judge Major filing a dissenting opinion. Petitioners' petitions for a rehearing and for a rehearing in banc were thereafter denied, Judge Duffy dissenting as to the latter petition, upon which Judge Major did not vote. Judge Duffy was not a member of the division of the court which heard the case.

Petitioners are now, and at all times hereinafter mentioned were, husband and wife, residing in Chicago, Cook County, Illinois. (Record 3) During the years 1944 through 1946, they purchased an aggregate 3,633 shares of 7% cumulative prior preference stock of Portland, a public utility holding company, at an aggregate cost of $140,031.00. (Record 4) During 1948, petitioners sold all 3,633 shares of such stock for an aggregate net price of $608,063.16. They reported the difference between their aggregate cost and the aggregate net price, i.e., $468,032.16, as long-term capital gain on their joint income tax return for 1948. They paid income tax on the amount of this long-term capital gain. (Record 4)

Upon examination of petitioners' joint income tax return for 1948, the Internal Revenue Service took the position that $103,091.25 of the $468,032.16 reported by petitioners as long-term capital gain should be taxed as dividend income. Based on such adjustment of their taxable income for 1948, petitioners paid an income tax deficiency for such year of $39,076.12, plus interest of $7,731.07, a total of tax plus interest of $46,807.19. Said $46,807.19 was paid as

follows: $24,408.55 on March 20, 1952 and $22,398.64 on November 11, 1952. A claim for refund thereof was filed by petitioners with the Director of Internal Revenue for the First Collection District of Illinois on March 18, 1954. The Commissioner of Internal Revenue mailed a notice of disallowance of said claim to petitioners by registered mail on January 5, 1956. (Record 8-9) This suit for refund followed.

For some years prior to 1948 Portland was involved in a bankruptcy reorganization proceeding in the United States District Court for the District of Oregon and in a proceeding before the Securities and Exchange Commission relating to its liquidation as a public utility holding company. The reorganization was consummated pursuant to a formal Plan of Reorganization confirmed by the District Court on October 11, 1947. (Record 5, 10-44)

Under this Plan of Reorganization, PGE, a wholly-owned operating subsidiary of Portland, was to reclassify and increase its authorized common stock and to issue *to Portland* 905,963.58 60 shares of such new common stock in exchange for the previously outstanding common stock held by Portland. PGE was also to transfer to Portland a dividend in cash and in Portland's own bonds. *Portland* was then to distribute cash and common stock of PGE to the holders of Portland's bonds, prior preference and first preferred stock in exchange for the Portland securities held by them. (Record 5, 10-44)

Under the Plan of Reorganization, the holder of each share of Portland prior preference stock was to receive, in exchange therefor, [illegible] shares of common stock of PGE in full satisfaction of his rights, including all accrued and [illegible] dividends. (Record 5-6, 191) Holders of Portland first preferred stock were to receive ⅔ of a share of common stock of PGE for each share of their stock. (Record

19) Holders of Portland second preferred stock and common stock were to receive nothing under the Plan of Reorganization and these stocks were to be cancelled. (Record 20-21) The holders of Portland prior preference stock were to be given ten (10) years after entry of final decree in the reorganization within which to exchange such prior preference stock for common stock of PGE. (Record 6)

The distributions of PGE stock under the Plan were based upon the value of the properties of Portland, including the PGE stock, as of October 31, 1945. Subsequent to October 31, 1945, PGE had earnings which were of a value equivalent to the interest accruing to the holders of Portland bonds after October 31, 1945, and to the accrual of dividends on the prior preference stock of Portland after that date. (Record 30-33)

Out of the retained earnings of PGE earned after October 31, 1945, its directors on July 7, 1947, declared a special dividend of $3.00 per share to be paid on the new common stock of PGE when and if such stock should be issued pursuant to the Plan. (Record 6, 32, 44-46) In confirming the Plan in October 1947, the Oregon District Court expressly took this $3.00 special dividend into consideration in determining that the distributions of Portland's assets to the Portland security holders stood on a fair and equitable basis. (Record 33) It found that the distributions so computed would satisfy the claims of the bondholders, would enable the holders of the Portland prior preference stock to receive the par value of such stock, plus all accumulated dividends, and would leave some equity for the holders of the Portland first preferred stock. (Record 34)

On November 12, 1947, and on December 22, 1947, after confirmation of the Plan by the District Court on October 11, 1947, the directors of PGE declared additional special dividends of 45¢ each per share to be paid on the new com-

mon stock of PGE when and if such stock should be issued pursuant to the Plan. (Record 6, 47-50). In addition, on March 10, 1948 and June 8, 1948 the directors of PGE declared additional dividends of 45c each per share to be paid on the new common stock of PGE, such dividends to be paid to PGE stockholders of record on March 31, 1948, and June 30, 1948, respectively. (Record 6, 50-53) As to Portland securities which had not been exchanged on those dates, such dividends were to be paid **only** if and when such securities were exchanged for PGE stock and then **only pursuant to an assignment of such dividends by the Independent Trustees of Portland** to the holders of such securities at the time of exchange. (Record 50-53) The Independent Trustees of Portland were trustees for Portland in the bankruptcy reorganization. (Record 11)

The Plan of Reorganization became effective on February 2, 1948, from and after which date all holders of Portland prior preference stock, including petitioners, were entitled to exchange such stock for common stock of PGE, and to receive cash in the amount of $3.90 per share of PGE stock. The final decree of the Oregon District Court fixed June 4, 1961, as the final date on which such exchange must be made under the Plan. (Record 6-7)

Petitioners never exchanged their prior preference stock of Portland for common stock of PGE, and never received the dividends declared on the PGE stock. Instead, petitioners sold their prior preference stock of Portland on the open market at various times during 1948. (Record 4, 7) During all of 1948 there was active trading in the Portland prior preference stock, and quotations thereon were listed by the National Quotation Bureau, Incorporated. The quotations on the dates of sales by petitioners ranged from a low of 169 to a high of 181. (Record 8)

REASONS FOR GRANTING THE WRIT

I.

The Basic Rule of Law Asserted by the Majority of the Court of Appeals Is in Conflict with Decisions of the Court of Appeals for the Fifth Circuit.

The decision of the majority is difficult to analyze with precision. At one point, it is said that "the amounts of these [PGE] dividends were constructively received by plaintiffs and they are accountable therefor as ordinary income". (A 9) At another point, the majority opinion states that "plaintiffs, as an incident to the sale of their Portland stock, disposed of their right to the income embodied in the dividends which were payable thereon". (A-10) While the doctrines of constructive receipt of income and anticipatory assignment of income are not the same, the majority evidently relied upon both to hold petitioners taxable upon the dividends declared and payable upon PGE stock, stock which petitioners never owned.

In order for either doctrine to be applicable, however, petitioners must be treated as having constructively exchanged their Portland stock for stock of PGE, i.e., must be treated as having become PGE stockholders. But petitioners never made the exchange and never became PGE stockholders. They continued as Portland stockholders until they sold their Portland stock. During the entire period of ownership by petitioners, and during the entire calendar year 1948, there was an active market in Portland stock. Such stock had a definite market value, realizable by sale. The stock of PGE, with respect to which the dividends in question were declared, was the stock of a separate corporation, entirely distinct from Portland. **The dividends in question were to be paid on PGE stock only "when and if" such stock was issued in exchange for Port-**

land stock, and then only pursuant to an assignment of such dividends by the Independent Trustees of Portland.

The holders of Portland stock were given until June 4, 1961 to make such exchange—a date still in the future.

The making of a taxable exchange was, therefore, a condition precedent to the receipt of PGE dividends, but such exchange need not have been made in 1948. If the exchange were not effected in that year, Portland stockholders did not become PGE stockholders and thus were not entitled to receive in that year any dividends declared on the PGE stock. If they did not make the exchange on or before June 4, 1961, they would never become entitled to the PGE dividends.

Thus, before it can be held that petitioners *constructively received* PGE dividends, it must be assumed that petitioners *constructively exchanged* Portland stock for PGE stock and thus became entitled to the PGE dividends. Similarly, before it can be held that petitioners *assigned* a right to PGE dividends, it must be assumed that petitioners *constructively exchanged* their Portland stock for PGE stock and thus obtained a right to dividends on the latter stock which could be assigned. In his dissent, Judge Major clearly recognized that this assumption of a constructive exchange of stocks was the basis upon which the majority opinion rested when he stated:

> The constructive receipt theory must be predicated upon the fictional premise that the PGE shares were constructively received by plaintiffs and, having been thus received, the dividends declared thereon were also constructively received. Thus, one constructive receipt is imposed upon another. I know of no case which supports this two-fold imposition of the theory. (A-14)

The concept of constructive exchange is based upon a postulated rule of law, i.e., that **because petitioners had**

the absolute right to make a taxable exchange of Portland stock for PGE stock, they must be viewed as having made such an exchange." This rule of law, fundamental to the decision of the majority of the Court of Appeals, is in direct conflict with the decision of the Court of Appeals for the Fifth Circuit in the case of *Prescott* v. *Commissioner*, 76 F.2d 3 (CCA 5, 1935). The *Prescott* case involved a holding company, Coca Cola International Corporation (hereinafter referred to as "International"), which held a majority of the stock of Coca Cola Company (hereinafter referred to as "Coca Cola"). International had the same number of shares outstanding as it owned shares of Coca Cola, so that one share of Coca Cola lay behind each share of International. In 1926 the directors of International *irrevocably* authorized each shareholder of International to exchange his shares of International for shares of Coca Cola on a share for share basis. Three years later, in 1929, the taxpayers, Mr. and Mrs. Prescott, exchanged their shares of International for shares of Coca Cola. The question before the Court of Appeals for the Fifth Circuit was when should the Prescotts be taxed on the gain realized by them on this exchange? As *in the instant case* the Government contended that the Prescotts *constructively exchanged* their International shares when they **first** had the right to make the exchange, i.e., 1926. However, the Court of Appeals for the Fifth Circuit held that the taxpayers were not subject to tax until 1929, when they **actually** made the exchange. The Court of Appeals pointed out that in 1926 the taxpayers were merely granted an **option** to make the exchange. Such option to exchange did not cut the taxpayers off as stockholders of International nor invest them with ownership in any of the Coca Cola stock unless or until they accepted the offer and exchanged their International stock. This the Prescotts did not do

until 1929, and only then did they realize on the original investment in the International stock.

The similarity of the Prescott case to the instant case is striking. International, a holding company, was liquidating but it had not yet completed its liquidation at the time when the Prescotts made their exchange of International stock for that of Coca Cola, although the option to make such exchange had been available to them for three years. In the instant case Portland was a holding company which was being liquidated. Such liquidation could not be completed until the distribution to its shareholders of all of its assets, including the stock of PGE. The stockholders had until June 4, 1961 to exchange their Portland stock for PGE stock. Thus, the liquidation of Portland might continue until June 4, 1961. **If the Prescotts made no constructive exchange in 1926—and the Court of Appeals for the Fifth Circuit so held—then the petitioners made no constructive exchange of their Portland stock on February 2, 1948 when they first had an opportunity to exchange it for PGE stock, and if no constructive exchange took place, petitioners could not be held to have received or sold PGE dividends.**

While neither the majority opinion nor Judge Major's dissenting opinion referred to the *Prescott* decision, the conflict was clearly recognized by Judge Major who pointed out that petitioners "and other shareholders, as well as their assignees, acquired a right, an option, which was exercisable at any time within ten years". (A 13). Judge Major's opinion throughout stressed this concept that petitioners had no more than an option which they could exercise, "or not, at their own discretion." Compare this with the language of Judge Sibley who said of the resolution authorizing the exchange in the *Prescott* case that it "was only an authority or option offered to each stockholder. It did not cut him off as a stockholder or invest him with

ownership of any Coca Cola stock unless or until he accepted the offer and tendered exchange of his stock". (76 F.2d at 4)

Note, too, the later decision of the Court of Appeals for the Fifth Circuit in *Citizens & Southern National Bank* v *Commissioner*, 136 F. 2d 406 (CA-5, 1943). That case also involved Coca Cola International Corporation and Coca Cola Company. The taxpayer in the *Citizens Bank* case made no exchange of its International shares for Coca Cola shares until 1936, although it had the absolute right to do so at any time after passage of the irrevocable resolution of the International directors in 1926. In 1936 Citizens Bank concluded to sell its International shares; however, its broker advised that the International stock be first exchanged for Coca Cola shares to facilitate the sale. The exchange was made and the Coca Cola shares were sold.

The taxpayer contended that the entire operation should be treated as a sale of International shares producing a long term capital gain. The Court of Appeals, however, held that the taxpayer engaged in two separate and distinct transactions, each having substance. It first surrendered International stock for cancellation and retirement and received Coca Cola stock in exchange, and thereafter sold the Coca Cola stock. Under the provisions of the law then in effect, the taxpayer was not entitled to long-term capital gain treatment of its gain on the liquidation exchange of International shares for Coca Cola shares. If the taxpayer had in fact sold its International shares to a purchaser who thereafter made the exchange, the resulting gain would have been subject to tax computations under the favorable long term capital gains statute. In the identical situation in the instant case, petitioners sold their Portland stock to purchasers who thereafter made the exchange of such stock for stock of PGE. Petitioners should be entitled to long-term capital gain on such sale.

The conflict between these holdings of the Court of Appeals for the Fifth Circuit and that of the majority of the Court of Appeals in this case should be resolved by this Court.

II.

The Decision of the Majority of the Court of Appeals is Self-Contradictory and Devoid of Factual Support.

Petitioners contend that even if the so-called PGE dividends had been paid to them either actually or constructively, such payments would have given rise to capital gain as easily received in the complete liquidation of Portland. This position is supported by the case of *Lelia S. Kirby*, 35 B.T.A. 578 (1937), acq. 1938-1 C.B. 17, reversed on another issue, 102 F. 2d 115 (CCA-5, 1939). In the *Kirby* case, during the liquidation of The Texas Banking & Investment Co. (herein referred to as "Texas Banking"), dividends were paid to the Liquidating Trustees of Texas Banking by Gladys City Oil, Gas & Manufacturing Co., a wholly-owned subsidiary of Texas Banking. These dividends were then distributed by the Liquidating Trustees to John H. Kirby, a stockholder of Texas Banking. The Board of Tax Appeals held that such distributions to Kirby were liquidating dividends and entitled to capital gain treatment stating:

> • • • all of said assets, including dividends, were received by him as liquidating dividends, and not as ordinary dividends, for they were all received through the liquidating trustees and, although the Gladys City Oil, Gas & Manufacturing Co. dividends were ordinary dividends so far as distribution by it was concerned, nevertheless they were paid to the liquidating trustees of the Texas Banking & Investment Co. who distributed same by way of liquidating. Therefore when received by John H. Kirby, these were liquidating dividends. • • • (35 B.T.A. at 600).

The majority of the Court of Appeals in this case accepted the rule of law set forth in the *Kirby* case, and stated that "of course" the dividends distributed to Kirby "were taxable on a capital gains basis only." At the same time, the majority stated that the *Kirby* principle was not applicable here because the PGE dividends "were never the property of Portland and therefore could not have been distributed as a liquidating dividend of Portland". (A-12) This statement, upon which the majority decision denied petitioners' alternative contention, is devoid of factual support and is contradicted by the court's own finding of facts.

Under the Plan of Reorganization PGE was to reclassify and increase its common stock and **"issue to Portland 608,966 58/60 shares of such new common stock *in exchange* for the previously outstanding common *held by* Portland".** (A-5) **Such shares were issued in the names of the Independent Trustees of Portland.** (Record 41) "The Independent Trustees of Portland were trustees for Portland in the bankruptcy reorganization". (A-7) "*Portland* was then to distribute cash and common stock of PGE to the holders of Portland's bonds and prior preference and first preferred stock in exchange for the Portland securities held by them". (A-6) The resolutions declaring PGE dividends after February 2, 1948, the effective date of the Plan, specifically provided that the dividends should be paid to the holders of Portland securities only when and if they exchanged such securities for PGE stock and "then only pursuant to an assignment of such dividends by the Independent Trustees of Portland to the holders of such securities at the time of the exchange". (A-7) **Such assignment would not have been necessary were the dividends not the property of Portland in the first instance.**

It is thus clear that the facts in the instant case are identical to those in the *Kirby* case. Portland was in the process of complete liquidation. During the liquidation

cash dividends were paid to the Independent Trustees of Portland by PGE, the wholly-owned subsidiary of Portland. Such cash was then distributable, together with the PGE stock, to the stockholders of Portland in liquidation of Portland. Although the PGE dividends were ordinary dividends so far as the distribution by PGE was concerned, nevertheless they were paid to the Independent Trustees of Portland who distributed its resulting income to the stockholders of Portland by way of liquidation. If petitioners constructively received these distributions they were received in the liquidation of Portland and were entitled to capital gain treatment. See Sec. 115(c), Internal Revenue Code of 1939; Regs. 111, § 29.115-5.

In failing to follow the *Kieferdorf* decision, the court below ignored uncontroverted facts requiring the application of the principles of law enunciated therein—facts which the court itself set forth in its opinion. The self-contradictory and groundless nature of the court's opinion in this point calls for the exercise of this Court's power of supervision.

III.

There Was a Difference of Opinion Among the Judges of the Division of the Court of Appeals Which Heard this Case with Respect to the Application of the Rules of Law Established by Decisions of this Court and Among the Judges of the Full Court as to the Need for a Rehearing In Banc.

This case was argued before a three-judge division of the Court of Appeals for the Seventh Circuit. The majority held in favor of respondent, Judge Major filing a strong dissenting opinion in which he referred to the "fallacy" of the majority's reasoning. Petitioners petitioned both for a rehearing and for a rehearing in banc because

of the importance of the decision. Both petitions were denied without comment. However, Judge Major, as a retired judge, did not vote upon the petition for a rehearing in banc, which petition was consequently passed upon by the remaining five members of the Court of Appeals. The rehearing was denied, Judge Duffy dissenting. It is thus apparent that the membership of the Court of Appeals for the Seventh Circuit is sharply divided as to the result which should obtain in the instant case.

Both the majority opinion and Judge Major, dissenting, relied upon the landmark decision of this Court dealing with the subject of an anticipatory assignment of income, *Helvering* v. *Horst*, 311 U.S. 112 (1940), the majority also relying upon the equally important decision of this Court on the subject of constructive receipt, *Corliss* v. *Bowers*, 281 U.S. 376 (1930). Petitioners submit that the sharp cleavage of opinion in the Court of Appeals as to the applicability of the broad general rules of law enunciated by this Court in these decisions indicates a need for this Court to define and enlarge upon the application of such rules of law in the area of constructive exchanges and as applied to sales of corporate stock.

As Judge Major so clearly understood and stated in his dissenting opinion, petitioners, on February 2, 1948, acquired nothing more than an option, exercisable at any time through June 4, 1961, to exchange their stock of Portland for stock of PG&E. The exchange would have been taxable just as would a sale of the Portland stock. Thus, realistically, petitioners had an option no different than that which the holder of any marketable security has throughout the period of his ownership, i.e., an option to retain the security and enjoy whatever benefits of ownership accrue therefrom, or to sell or exchange the security

in a taxable transaction and thereby to acquire cash or a different security with different benefits of ownership.

In the *Horst* case, a father who owned negotiable bonds detached the interest coupons and delivered them to his son, who collected them at maturity later in the same year. This Court held that the father was taxable on the interest when it was received by his son, since he had the unqualified and unfettered right to the receipt of such interest. However, as Judge Major observed, the *Horst* principle could hardly be extended to tax the father on the receipt of interest where he had no more than an option, exercisable at will, to purchase the bonds with the interest coupons attached. If the father were not taxable on the interest because of his option to purchase the bonds, could he be taxed as being in receipt of interest if he sold his option at a price enhanced by reason of the interest coupons attached to the bonds which were the subject of the option?

Pointing up the inapplicability of the *Horst* principle in terms of the time-honored "fruit and tree" simile, petitioners never were the owners of the "tree" (PGE stock) from which the "fruit" (PGE dividends) was produced. Not being the owner of the "tree," petitioners could hardly have assigned the "fruit" of the "tree," as the father who owned the interest-bearing bonds did when he assigned the interest coupons and retained the bonds. Going further, if it be said that the "tree" involved was Portland stock and the "fruit" was PGE stock, plus dividends, it is nevertheless indisputable that petitioners did not sell the "fruit" and retain the "tree," but sold the tree *in toto*. The facts of this case fall within the previously well-recognized rule stated in Mertens, *Law of Federal Income Taxation* (1958), Vol. 3B, § 22.40 (p. 182):

> In the case of stock, if the totality of rights represented by it are sold at a time before the dividend becomes separable from the stock, and the expected "fruit" of the dividend is sold together with the "tree" of the stock, it seems clear that the total proceeds of the sale are from the disposition of a capital asset.

The fallacy of taxing petitioners on the PGE dividends is graphically pointed up by applying such a rule consistently to subsequent purchasers of the Portland stock. If the PGE dividends are properly taxable to petitioners, then the same dividends *must also be taxed* to the purchasers from petitioners since such purchasers received nothing more than petitioners owned, i.e., the Portland stock which carried with it the option to exchange it for PGE stock. Likewise purchasers from purchasers *ad infinitum* must also be taxed on the same PGE dividends, since each successive purchaser would have the option to exchange the Portland stock for PGE stock and then to receive the PGE dividends. As a matter of fact, the purchasers from petitioners **did** exchange the Portland stock for PGE stock, **did** receive the PGE dividends and **did** pay tax on the dividend income. Thus two taxpayers have in fact been taxed on the *same* dividend income—a result without justification, as noted by Judge Major.

The foregoing examples may seem extreme. Nevertheless, they follow naturally from the court's application of the doctrines of constructive receipt and anticipatory assignment of income established by the decisions of this Court. It is respectfully submitted that this extension of the holdings of this Court is erroneous and calls for the exercise of this Court's power of review in order to clarify the rules of law involved and to correct the misinterpretation thereof inherent in the instant decision.

IV.

The Decision of the Majority of the Court of Appeals Is of Extreme Importance to the Financial Community Because of its Implications in All Cases Involving a Sale of Stock After a Dividend Has Been Declared But Prior to the Ex Dividend or Record Date.

As noted above, the decision of the Court of Appeals essentially stands for the proposition that any taxpayer who has an option to make a taxable exchange must be deemed to have made such an exchange and must suffer whatever tax consequences flow therefrom. Absurd though it may seem, it is but a short step to expand this doctrine to include taxpayers who have an option to make a sale. Certainly, any decision carrying such implications to taxpayers in general is of great importance and any pronouncement to such effect should be reviewed by the Supreme Court of the United States.

In addition, the decision shakes the well-established rules of federal tax law applicable to sales of stock after a dividend has been declared but prior to the record or ex-dividend date. Many thousands of such transactions occur daily. It has been clear that in such a case, even though the sales price admittedly includes the accrued dividend, such portion of the price is not taxable to the seller as ordinary income, but rather is included in the computation of his capital gain or loss. When the dividend is received by the buyer it is taxable to him as ordinary income. Reg. 1.61-9(c); cf. Reg. 111, 29.22(a)-14.

The decision of the Court of Appeals here, however, would indicate that, because the seller might have retained the stock and received the dividend as ordinary income, such portion of the sale price as reflects the value of the declared dividend is taxable to the seller as ordinary in-

come. It is submitted that any decision to such effect should be carefully considered by this Court as a matter of policy involving federal law.

CONCLUSION

For each of the foregoing reasons, we earnestly urge that this petition be granted and that this Court's writ of certiorari issue to the Court of Appeals for the Seventh Circuit to review its decision in the instant case.

Respectfully submitted,

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APPENDIX

STATUTES AND REGULATIONS INVOLVED

INTERNAL REVENUE CODE OF 1939

22(a): "Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service . . . of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. . . .

115(a): "The term dividend . . . means any distribution made by a corporation to its shareholders . . . whether in money or other property. . . .

115(c): "Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock . . . and amounts distributed in partial liquidation of a corporation . . . shall be treated as in part or full payment in exchange for the stock . . . or as a distribution to which section 115(a) applies, or as both, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary. . . .

INCOME TAX REGULATIONS 111, UNDER 1939 CODE

29.22(a)-1: "The fact that a dividend is declared shortly after the sale of corporate stock and the sale price is influenced by the expectation of the payment of a dividend does not make such dividend, when paid, taxable to the vendor as a dividend. The amount advanced by the vendee to the vendor in con-

templation of the next dividend payment is an investment of capital and may not be claimed as a deduction from gross income. * * *"

29.42-2: "Income which is credited to the account of or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which so credited or set apart, although not then actually reduced to possession. To constitute receipt in such a case the income must be credited or set apart to the taxpayer without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made, and must be available to him so that it may be drawn at any time, and its receipt brought within his own control and disposition. * * *"

29.42-3: "* * * Dividends on corporate stock are subject to tax when unqualifiedly made subject to the demand of the shareholder. * * *"

29.115-5: "Amounts distributed in complete liquidation of a corporation are to be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation are to be treated as in part or full payment, in exchange for the stock so cancelled or redeemed. The gain or loss to a shareholder from a distribution in liquidation is to be determined, as provided in section 111 and section 29.111-1, by comparing the amount of the distribution with the cost or other basis of the stock provided in section 113; but the gain or loss will be recognized only to the extent provided in section 112, and shall be subject to the conditions and limitations provided in section 117. * * *"

INCOME TAX REGULATIONS UNDER 1954 CODE

1.61-9(c): "When stock is sold, and a dividend is both declared and paid after the sale, such dividend is not gross income to the seller. When stock is sold after the declaration of a dividend and after the date as of which the seller becomes entitled to the dividend, the dividend ordinarily is income to the seller. When stock is sold between the time of declaration and the time of payment of the dividend, and the sale takes place at such time that the purchaser becomes entitled to the dividend, the dividend ordinarily is income to him. The fact that the purchaser may have included the amount of the dividend in his purchase price in contemplation of receiving the dividend does not exempt him from tax. Nor can the purchaser deduct the added amount he advanced to the seller in anticipation of the dividend. That added amount is merely part of the purchase price of the stock. * * *"

OPINION OF COURT OF APPEALS

IN THE

UNITED STATES COURT OF APPEALS

FOR THE SEVENTH CIRCUIT

No. 12762 SEPTEMBER TERM, 1959 JANUARY SESSION, 1960

AVERY BRUNDAGE and ELIZABETH D. BRUNDAGE, *Plaintiffs-Appellants*, v. UNITED STATES OF AMERICA, *Defendant-Appellee*.	Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

February 5, 1960

Before MAJOR, SCHNACKENBERG and CASTLE, *Circuit Judges*.

SCHNACKENBERG, *Circuit Judge*. Avery Brundage and Elizabeth D. Brundage, his wife, plaintiffs, appealed from the district court's order dismissing with prejudice and costs their complaint for a refund of federal income tax in the amount of $39,076.12, paid by them as a deficiency for the calendar year 1948, plus interest in the amount of $7,731.07, paid by them upon said deficiency, a total of $46,807.19, plus interest on said total as allowed by law.

Defendant, United States of America, having filed an answer, the facts were stipulated.

The court entered findings of fact and conclusions of law.

During the years 1944-1946, plaintiffs acquired 3,533 shares of 7% cumulative prior preference stock of Portland Electric Power Company (hereinafter referred to as "Portland"), a public utility holding company, at a cost of $140,031. During 1948 plaintiffs sold all of such stock (also herein referred to as prior preference stock) for an aggregate net price of $608,063.16. They reported the difference between said cost and said sale price, *i.e.*, $468,032.16, as long-term capital gain on their joint income tax return for 1948, and paid income tax on said gain.

The internal revenue service contended that $103,091.25 of the $468,032.16 reported by plaintiffs as long-term capital gain was constructively received by plaintiffs as a dividend and should have been reported as dividend income, and adjusted plaintiffs' taxable income for 1948 accordingly. Based on said adjustment plaintiffs paid said deficiency.

For some years prior to 1948 Portland was involved in a bankruptcy reorganization proceeding in the United States District Court for the District of Oregon and in a proceeding before the Securities and Exchange Commission relating to its liquidation as a public utility holding company. The reorganization was consummated pursuant to a formal Plan of Reorganization[1] confirmed by the District Court on October 11, 1947.

Under this Plan, Portland General Electric Company (hereinafter referred to as "PGE"), a wholly owned operating subsidiary of Portland, was to reclassify and increase its authorized common stock and to issue to Portland 998,966.58 shares of such new common stock in exchange for the previously outstanding common held by Portland. PGE was also to transfer to Portland a

1. Herein sometimes referred to as the Plan.

dividend of $1,600,000 in cash and $93,000 principal amount in Portland's own bonds. Portland was then to distribute cash and common stock of PGE to the holders of Portland's bonds and prior preference and first preferred stock in exchange for the Portland securities held by them.[2]

Under the Plan, the holder of each share of prior preference stock was to receive, in exchange therefor, $6\frac{1}{4}$ shares of common stock of PGE in full satisfaction of his claims thereon, including all accrued and unpaid dividends. Holders of Portland first preferred stock were to receive $\frac{2}{3}$ of a share of common stock of PGE for each share of their stock. Holders of Portland second preferred stock and common stock were to receive nothing under the Plan and these stocks were to be cancelled. The holders of prior preference stock were to be given ten years after entry of final decree in the reorganization within which to exchange such prior preference stock for common stock of PGE.

The distributions of PGE stock under the Plan were based upon the value of the properties of Portland, including the PGE stock, as of October 31, 1945. Subsequent to October 31, 1945, PGE had earnings which were of a value equivalent to the interest accruing to the holders of Portland bonds after October 31, 1945, and to the accrual of dividends on the prior preference stock after that date.

Out of the retained earnings of PGE earned after October 31, 1945, its directors on July 7, 1947, declared a spe-

2. The holders of prior preference stock, by its terms, were entitled to cumulative dividends at the rate of 7% per annum from January 1, 1933, and upon liquidation or dissolution of Portland were entitled to priority over the holders of other classes of stock in the distribution of assets to the extent of $100 per share, together with unpaid accumulated dividends. The first preferred stock of Portland was junior to the prior preference stock, but ranked

cial dividend of $3 per share to be paid to the holders of the new common stock of PGE when and if such stock should be issued pursuant to the Plan. In confirming the Plan on October 11, 1947, the court found that the values of the properties of Portland as of October 31, 1945, plus the retained earnings of PGE plus the said $3 special dividend, were a fair and equitable basis for the distribution of the assets of Portland to its security holders. It found that the distributions so computed would satisfy the claims of the bondholders, would enable the holders of the prior preference stock to receive the par value of such stock plus all accumulated dividends, and would leave some equity for the holders of the first preferred stock.

On November 12, 1947 and on December 22, 1947, the directors of PGE declared additional special dividends of 45¢ each per share to be paid to the holders of the new common stock of PGE when and if such stock should be issued pursuant to the Plan. In addition, on March 10, 1948 and June 8, 1948, the directors of PGE declared additional dividends of 45¢ each per share to be paid to the holders of the new common stock of PGE, such dividends to be paid to stockholders of record on March 31, 1948 and June 30, 1948, respectively. As to Portland securities which had not been exchanged on those dates, such dividends were to be paid only if and when such securities were exchanged for PGE stock and then only pursuant to an assignment of such dividends by the Independent Trustees of Portland to the holders of such securities at the time of the exchange. The Independent Trustees of Portland were trustees for Portland in the bankruptcy reorganization.

Upon the consummation of the Plan Portland was to be completely dissolved and liquidated and was not to have any officers or directors.

By an order of the district court in Oregon, entered

named exchange agent in order to execute the Plan in accordance with its provisions. The newly issued common stock of PGE was delivered to the exchange agent on or before February 2, 1948. The special dividends, previously referred to, were paid to the exchange agent and held for future distribution to the holders of Portland securities upon the exchanges being made.

From and after the effective date of the Plan (February 2, 1948) the holders of prior preference stock were entitled to exchange such stock for common stock of PGE, and to receive the dividends thereon. The final decree of the court fixed June 4, 1951, as the last date on which such exchange must be made under the Plan. If the exchange were not made by that date, the stock would become valueless in the hands of the holders.

Plaintiffs never exchanged their stock for common stock of PGE and never received the dividends declared on the PGE stock. Instead, plaintiffs sold their stock at various times during 1948. During all of 1948 there was active trading in that stock, and quotations thereon were listed by the National Quotation Bureau, Incorporated, which ranged from a low of 169 to a high of 181 on the dates of sales by plaintiffs.

I. Plaintiffs contend that they were never stockholders of PGE and never received the dividends in question. While plaintiffs chose not to exchange their prior preference stock for common stock of PGE and so never directly received the dividends declared on the latter stock, they did sell their Portland stock in 1948 and it is undisputed that these sales carried the right to collect the dividends which defendant seeks to tax as income to plaintiffs. The purchasers of this stock acquired from plaintiffs the right to collect those dividends. Plaintiffs concede that they

sold a "totality of rights, *i.e.*, the tree as well as the fruit". It is incredible that the total sale price did not include the value of the accrued dividends, and they take no such contention. It is obvious that the value of the dividend rights sold was a part of the consideration which plaintiffs received when they sold their stock without exercising their right to collect the dividends themselves. Under these circumstances, for tax purposes the amounts of these dividends were constructively received by plaintiffs and they are accountable therefor as ordinary income.

Defendant relies upon the following sections of Treasury Regulation 111, under the Internal Revenue Code of 1939:

> Sec. 29.42-2. **Income not reduced to possession.** Income which is credited to the account of or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which so credited or set apart, although not then actually reduced to possession. • • •
>
> Sec. 29.42-3. **Examples of constructive receipt.** • • • Dividends on corporate stock are subject to tax when unqualifiedly made subject to the demand of the shareholder. • • •

Undoubtedly the underlying reason for these provisions is to be found, *inter alia*, in *Corliss* v. *Bowers*, 281 U.S. 376, 378, where the court said:

> • • • The income that is subject to a man's unfettered command and that he is free to enjoy at his own option may be taxed to him as his income, whether he sees fit to enjoy it or not. • • •

It is obvious that what plaintiffs sold was the right to obtain from the exchange agent the PGE shares, with accumulated dividends, for which the shares of Portland were exchangeable. Thus, plaintiffs realized ordinary in-

come to the extent of the amount of the dividends involved, which were in effect collected as a part of the sale price of their Portland stock. *Hilbert v. Commissioner*, 227 F.2d 399, 401. In such circumstances, plaintiffs, as an incident to the sale of their Portland stock, disposed of their right to the income embodied in the dividends which were payable thereon. The dominant purpose of the revenue laws is the taxation of income to those who enjoy the benefit of it when paid. See *Helvering v. Horst*, 311 U.S. 112, 116, and *Fisher v. Commissioner*, 209 F.2d 513, 515.

In *United States v. Swan*, 223 F.2d 103, 108, the court said:

> "The general rule is that a right to receive ordinary income, produced by a capital asset, is not transmuted into a capital asset by the sale or assignment of the capital asset together with the right to receive the ordinary income. * * *"

2. Plaintiffs make the further contention that, even if they had actually received the dividends declared by PGE, such payments would have given rise to *capital gain* as cash received in liquidation of Portland. They rely on § 115 (c) of the Internal Revenue Code of 1939[3] which provided:

> Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock. * * *

As to the $5 dividend declared on July 7, 1947, they point out that the Oregon district court found:

> "* * * Said special dividend, together with said retained earnings of Portland General Electric Company allocable to the stock to be distributed to the

3. 53 Stat. 870 (1939), § 115 (c).

beneficiaries of debtor, is of a value equivalent to the interest accruing upon the claims of the holders of the bonds of debtor subsequent to October 31, 1945, and that the portion represented by the stock to be allocated under the plan as amended to the prior preference stockholders is of a value equivalent to the accrual of dividends upon such prior preference stock subsequent to October 31, 1945.

"That the value of the properties of debtor as of October 31, 1945, together with the values of the special dividend hereinbefore mentioned and the retained earnings of Portland General Electric Company, are a fair and equitable basis for the distribution of the cash and other assets of debtor as provided in said amended plan to the security holders of debtor according to their respective claims, interests and priorities."

It is plaintiffs' theory that so of $3 dividend must be regarded as a distribution in the complete liquidation of Portland and, if constructively received by plaintiffs, it must be treated as payment in exchange for their Portland prior preference stock; and that, if plaintiffs are treated as having sold the right to such $3 dividend along with their Portland stock, then the proceeds of sale must be accorded similar treatment; in either case any gain must be taxed as capital gain.[4] They rely heavily on *Kirby v. Commissioner*, 35 B.T.A. 578, reversed on other grounds at 102 F.2d 115. However, we have examined the *Kirby* opinion and find that in that case ordinary dividends on stock owned by a corporation were paid to the liquidating trustees of that corporation and then distributed by them to its stockholders. Those dividends were taxable to the corporation. Of course, when they were thereafter distributed to its stockholders as a part of a complete

[4] Plaintiffs also contend that the dividends declared as November 12, 1947, December 22, 1947, March 10, 1948 and June 8, 1948

liquidation of the corporation, the taxholders were taxable on a capital gains basis only. The case at bar presents a different situation. Here the dividends on the PGE stock were never the property of Portland and therefore could not have been distributed as a liquidating dividend of Portland. These dividends were paid to the exchange agent to hold for the stockholders who were entitled to them, which included the plaintiffs or their assignees.

Paragraph VI (C) of the Plan provides:

> Holders of Prior Preference Stock upon consummation of the Plan are to receive in full satisfaction of their claims thereon, including all accrued and unpaid dividends, for each share of such stock, 6½ shares of PGE Common Stock and the rights of the holders of such stock shall be modified and altered accordingly.

It included all dividends plaintiffs were entitled to as of October 31, 1945. See *Petition of Portland Electric Power Co.*, 162 F.2d 618 (9 Cir.) where the Plan was approved.

We hold that the $3 and subsequent dividends on PGE stock were not liquidating distributions but were distributions of earned profits of PGE, a going concern, and are to be treated as ordinary dividends.

For the reasons herein stated, the order of the district court from which plaintiffs appeal is affirmed.

AFFIRMED.

MADDOX, *C.J.*, dissenting. My conviction that this case should be reversed is such that I feel compelled to dissent. Judge Schnackenberg has made an adequate statement of the facts and I disagree only with the rule which he applies thereto.

The government relies upon the theory of constructive receipt in holding plaintiffs accountable for the dividends as ordinary income. It appears to waver, however, as to the time of such receipt. It states in its brief, "* * * the dividend income was clearly realized by taxpayers in 1948, and it was so realized not later than the dates when collected as part of the proceeds of the sales of the Portland stock."

In my opinion, the rights and liabilities of Portland shareholders were definitely fixed on February 2, 1948, when the Plan of Reorganization was confirmed. On that date plaintiffs and other shareholders, as well as their assignees, acquired a right, an option, which was exercisable at any time within ten years. The Plan provided a formula by which Portland shareholders, upon compliance with the terms and conditions thereof, might at their option acquire PGE shares. If Portland shareholders desired to exercise the option thus afforded them, it was required that they exchange their shares for those of PGE upon which dividends had been declared. It was further required that they become record owners of PGE shares and, even then, they were entitled to dividends only "pursuant to an assignment of dividends from the independent trustees of Portland Electric Power Company to such shareholders."

How it can be thought or held under such circumstances that plaintiffs as shareholders of Portland had an unfettered and unqualified right to the receipt of dividends declared on PGE shares and made payable only to the record holders thereof is not discernible to me. Plaintiffs never owned any PGE shares and, in the exercise of a right provided by the Plan, were not required to become such owners.

The government emphasizes the point that plaintiffs' shares would have become valueless [illegible]

change within ten years, thus intimating that sooner
later they would have been under an economic compuls
to make such exchange. The theory is not tenable. T
wise, it was no concern of the government if plaint
exercising the rights conferred by the Plan, improvident
hold their shares until they became of no value. At a
rate, I am aware of no law which requires a person
produce income. The farmer has a right to permit
fields to lie fallow, and the merchant or professional m
can close the doors to his business or office, even for t
express purpose of avoiding income. Plaintiffs, under
circumstances, had the same right relative to their Po
land shares.

The constructive receipt theory must be predicated up
the fictional premise that the Polk shares were constru
tively received by plaintiffs and, having been thus
ceived, the dividends declared thereon were also constru
tively received. Thus, one constructive receipt is impos
upon another. I know of no case which supports this tw
fold imposition of the theory.

The theory relied upon is perhaps best illustrated
Helvering v. *Horst*, 311 U.S. 112, which has been oft
cited and followed. There, a father, owner of negotiab
bonds, detached therefrom interest coupons before the
due date and delivered them to his son who collected the
at maturity but in the same year. It was held that t
father was accountable for the interest represented by t
coupons on the theory of constructive receipt. Obviously
the father as owner of the bonds had the unqualified an
unfettered right to the receipt of such interest. Suppose
however, that the interest of the father in that case ha
been limited to an option, exercisable at will, to purchas
the bonds with the coupons attached. Could it be seriously
contended that he would be required to account for a
ordinary income the interest earned on such bonds? Con

reason that plaintiffs as shareholders of Portland did not have an unqualified and unfettered right to the receipt of dividends which had been declared on PGE shares.

This constructive receipt theory, if applicable, could produce the incongruous result of numerous taxpayers being held accountable for the same dividends. The Portland shares might have been sold many times before they reached a purchaser who was willing to exchange such shares for those of PGE and thereby receive the dividend. It happens in the instant case that the purchaser elected to make the exchange and receive the dividends. The stipulation entered in the case includes the claim for refund filed by plaintiffs. That claim discloses without denial that such exchange was made by the purchaser who reported as ordinary income the amount received as dividends and paid the tax thereon. Ti is, both plaintiffs as sellers of Portland shares and the purchaser of such shares have been taxed upon the same dividend income. It is interesting, although perhaps immaterial, to contemplate how the government would defend its right to collect from different parties a tax upon the same income. This situation, however, furnishes strong support for my position, that is, that only an owner of Portland shares who elected to exercise his option of making an exchange for PGE shares was accountable for dividend income.

I would reverse and remand the case, with directions that a judgment be entered in favor of plaintiffs.

A true Copy:
Teste:

Clerk of the United States Court of Appeals for the Seventh Circuit

JUDGMENT ORDER

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT
Chicago 10, Illinois

Friday, February 5, 1960

Before

Hon. J. Earl Major, Circuit Judge
Hon. Elmer J. Schnackenberg, Circuit Judge
Hon. Latham Castle, Circuit Judge

No. 12762

Avery Brundage and Elizabeth D. Brundage, *Plaintiffs-Appellants*, v. United States of America, *Defendant-Appellee*.	Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Illinois, Eastern Division, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the judgment of the said District Court in cause appealed from be, and the same is hereby, AFFIRMED, in accordance with the opinion of this Court filed this day.

ORDER DENYING PETITION FOR REHEARING

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT
Chicago 10, Illinois

Wednesday, March 30, 1960

Before

Hon. ELMER J. SCHNACKENBERG, Circuit Judge
Hon. LATHAM CASTLE, Circuit Judge
Hon. J. EARL MAJOR, Circuit Judge

No. 12762

AVERY BRUNDAGE, et al., *Plaintiffs-Appellants,* v. UNITED STATES OF AMERICA, *Defendant-Appellee.*	Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

IT IS ORDERED by the Court that the appellants' petition for a rehearing of this cause be, and the same is hereby, DENIED.

ORDER DENYING PETITION FOR REHEARING IN BANC

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT
Chicago 10, Illinois

Wednesday, March 30, 1960

Before

Hon. JOHN S. HASTINGS, Chief Judge
Hon. F. RYAN DUFFY, Circuit Judge
Hon. ELMER J. SCHNACKENBERG, Circuit Judge
Hon. WM. G. KNOCH, Circuit Judge
Hon. LATHAM CASTLE, Circuit Judge

No. 12762

...VERY BRUNDAGE, et al.,
Plaintiffs-Appellants,

v.

...NITED STATES OF AMERICA,
Defendant-Appellee.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

IT IS ORDERED by the Court that the appellants' petition for a rehearing *in banc* of this cause be, and the same is hereby, DENIED.

...UFFY, C. J. dissents).

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No. 135

In the Supreme Court of the United States

OCTOBER TERM, 1960

AVERY BRUNDAGE AND ELIZABETH D. BRUNDAGE,
PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

J. LEE RANKIN,
Solicitor General,
CHARLES K. RICE,
Assistant Attorney General,
HARRY BAUM,
HELEN A. BUCKLEY,
Attorneys,
Department of Justice, Washington 25, D.C.

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In the Supreme Court of the United States

OCTOBER TERM, 1960

No. 135

AVERY BRUNDAGE AND ELIZABETH D. BRUNDAGE,
PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The findings of fact and conclusions of law of the district court (R. 83–88) are not officially reported. The opinion of the court of appeals (Pet. A4–A16) is reported at 275 F. 2d 424.

JURISDICTION

The judgment of the court of appeals was entered on February 5, 1960 (Pet. A17). Timely petitions for rehearing and for rehearing *en banc* were denied on March 30, 1960 (Pet. A18–A19). The petition for a writ of certiorari was filed on June 9, 1960. The

jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

Under a plan of liquidation of a parent corporation, its stockholders were entitled to receive, upon presentation of their stock certificates, a specified number of shares of the common stock of a subsidiary. The questions presented are:

1. Whether dividends becoming payable on the subsidiary's stock after the effective date of the plan were taxable to holders of the parent's stock who had not yet exercised their unconditional right to receive the stock of the subsidiary.

2. Whether, if not, that part of the proceeds of a sale of the parent's stock after the effective date of the plan which was allocable to the right to receive the dividends then payable on the subsidiary's stock was taxable as ordinary income.

3. Whether dividends declared on the subsidiary's stock by a resolution passed before the effective date of the plan but payable only if and when the plan was consummated were taxable to the parent corporation or to the persons entitled to receive the subsidiary's stock upon consummation.

STATUTES AND REGULATIONS INVOLVED

The relevant statutes and regulations are set forth in the petition at pp. A1–A3.

STATEMENT

1. On October 11, 1947, the United States District Court for the District of Oregon confirmed a plan of reorganization of the Portland Electric Power Co. ("Portland") (R. 24–44). The plan, effective February 2, 1948, provided for Portland's dissolution and the distribution to its securityholders of all its assets, consisting principally of the common stock of its subsidiary, Portland General Electric Co. ("PGE") (R. 10–24). The common stock of PGE was to be reclassified for the purpose, and holders of the prior preference stock of Portland were to receive, for each share, $6\frac{1}{2}$ shares of the reclassified PGE stock (R. 16–17, 19). On or before the effective date of the plan, the reclassified stock of PGE was delivered to an exchange agent for distribution to the participants under the plan upon surrender of their Portland securities (R. 6). The decree of confirmation declared all Portland securities to be "null and void" except for purposes of the transfer and exchange provided for by the plan (R. 42), and all rights to participate under the plan were to lapse upon a failure of any securityholder to present his bond or stock certificate within ten years of the final decree (R. 6–7; 22).

2. Prior to the effective date of the plan but in anticipation of its consummation, the board of directors of PGE adopted resolutions declaring dividends to be paid on its reclassified stock upon consummation of the plan. The resolution of July 7, 1947, after reciting that the plan contemplated PGE's issuance

of reclassified stock and the distribution of that stock to the Portland securityholders, declared a dividend of $3 a share on the reclassified stock "to be paid to the holders of said reclassified common stock * * * when and if the same is reclassified and issued pursuant to" the plan "after * * * consummation of said plan of reorganization shall have been completed," the resolution to be null and void if the plan were not consummated (R. 44–46). Substantially similar resolutions, each declaring a $0.45 dividend, were adopted on November 12 and December 22, 1947 (R. 47–50).

After the effective date of the reorganization plan, on March 10 and June 8, 1948, PGE declared two more $0.45 dividends, the resolutions providing that if there were Portland securityholders who had not yet exchanged their Portland securities for PGE stock "then this dividend shall be paid to said holders if and when [PGE stock] is issued to such holders [pursuant to the reorganization plan]. It is intended that this dividend shall be paid at the time of the issuance of [PGE stock] in accordance with said plan of exchange and pursuant to an assignment of dividends from the Independent Trustees of Portland * * * to said stockholders of [PGE] who have not prior to the record date * * * made the exchange of" Portland securities for PGE stock (R. 50–53).

The confirmation decree of October 11, 1947, acknowledged the $3 dividend declared by PGE on July 7, 1947, and directed PGE, upon the plan's becoming effective, to segregate the dividend in a special ac-

count and thereafter distribute it "to the persons entitled to receive [the PGE stock] under said plan of reorganization." Any dividends subsequently declared were to be similarly segregated and paid "to the holders of its reclassified stock upon the issuance of such stock to the persons entitled thereto under the said plan" (R. 41–42). The several dividends were in fact paid over to the exchange agent for disbursement to the participants under the plan upon the exchange of their Portland securities for the PGE stock (R. 6).

3. Petitioners, as of the effective date of the plan, owned 3,633 shares of the prior preference stock of Portland and, as noted above, were entitled under the plan to receive 6⅓ shares of PGE stock for each such share. They did not, however, exercise their right to surrender their Portland stock for the PGE stock but rather sold the Portland stock itself to third parties at various times during 1948 (R. 4–5, 7). The total dividends which had become payable on the PGE stock allocable to petitioners' Portland stock before the dates on which they sold their Portland stock amounted to $103,091.25 (R. 88).

On their income tax return for 1948, petitioners reported their entire gain on the sales of their Portland stock ($468,032.16) as a long-term capital gain (R. 4). The Commissioner held that $103,091.25 of the proceeds of the sales represented the dividends accrued on the PGE stock and was taxable as ordinary income (R. 8–9). The resulting deficiency was paid and in due course this suit for refund was brought

(R. 9). The district court upheld the Commissioner's determination (R. 83–88), and the court of appeals affirmed (Pet. A4–A16).

ARGUMENT

1. When the reorganization plan became effective on February 2, 1948, petitioners became unconditionally entitled to receive the PG&E shares allocable to their Portland stock, together with any dividends becoming payable on the stock. The stock and dividends were delivered to the exchange agent, there simply to await petitioners' demand for them. Both the stock and the dividends were thus unqualifiedly subject to petitioners' demand and hence constructively received by them. It follows that petitioners were taxable on the dividends on the PG&E stock when they first became payable (Regs. 111, § 29.42-2 and 3; *Corliss* v. *Bowers*, 281 U.S. 376).

Petitioners' contention that they had only an unexercised "option" to acquire the PG&E stock in an "exchange" for their Portland stock is misleading to the extent that it implies that their right to the PG&E stock was conditioned upon their giving up a separate property interest of value. After the effective date of the plan, Portland stock was "null and void" for any purpose other than to entitle the holder to the PG&E stock. It thus ceased to be "stock" at all and became neither more nor less than a certificate evidencing that right. To obtain the PG&E stock, petitioners had but to exercise their right to demand it.

giving nothing in exchange. Their "option", if it be called that, was simply an "option" either to assert their unconditional rights or to allow them to lapse by time.

2. While we think it clear that the dividends were constructively received by petitioners when they first became payable to the exchange agent, it makes no difference in this case (since all the events occurred in a single taxable year) if the transaction is viewed instead as an anticipatory assignment of income which petitioners later sold their rights to the PGE stock and the accrued dividends thereon. Petitioners had a vested right, by merely surrendering their Portland stock certificates to the transfer agent, to receive the dividends already paid on the PGE stock. They could not convert that accrued right to ordinary income into capital asset by selling it, and the portion of the purchase price attributable to the dividends already declared and payable was taxable as ordinary income. Cf. *Commissioner v. P. G. Lake, Inc.*, 356 U.S. 260; *Hort v. Commissioner*, 313 U.S. 28; *Helvering v. Horst*, 311 U.S. 112.

3. Petitioners contend alternatively that, even if they had received the PGE stock on the date the plan became effective, the previously-declared dividends

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For that reason, *Pacific Co. v. Commissioner*, 70 F. 2d 1 (C.A. 9), alleged by petitioners to be in conflict, is not in point. There the parent corporation continued to exist and to pay dividends on its own behalf, its stockholders simply being given the option to give up a continuing stock interest in the parent in exchange for a direct stock interest in the subsidiary. Patently no taxable event occurred until the option was exercised.

then payable should be treated as having been paid in the first instance to *Portland* (and presumably taxable to it) and then distributed to petitioners, not as "dividends" from PGE, but as a liquidating distribution from Portland.[7] The fallacy in the argument is that the dividends, although declared by resolutions adopted before the effective date of the plan, were expressly made contingent upon consummation of the plan and hence were payable only after the rights to the PGE stock had become vested in the Portland securityholders to whom it was to be distributed. Petitioners became entitled to the dividends on the PGE stock not by a distribution of miscellaneous cash from Portland but solely by virtue of their rights to the PGE stock given them by the plan before the dividends became payable, and Portland itself never acquired any beneficial interest in the dividends.

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[7] The same contention is also made as to the dividends declared after the effective date of the plan, but the taxability of those dividends is *a fortiori* to the taxability of the previously-declared dividends.

[8] In *Kirby* v. *Commissioner*, 35 B.T.A. 578, reversed on other issues, 102 F. 2d 115 (C.A. 5), relied on by petitioners (Pet. 14), the very premise of the decision was a finding that the stock in the hands of the liquidating trustees on which the dividends were paid had not, when the dividends were paid, been "set apart for him [the stockholder of the liquidating corporation to whom the funds were ultimately paid over] without substantial limitation or restriction as to time or manner of payment or use or enjoyment by him" but were rather still in the control of the trustees and, indeed, subject to various suits and injunctions preventing their distribution (35 B.T.A. at 599). Here, to the contrary, when the dividends became payable (upon consummation) the PGE stock was unqualifiedly available to petitioners on demand.

CONCLUSION

The decision below is clearly correct and there is no conflict. The petition for a writ of certiorari should be denied.

Respectfully submitted.

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